

## Exhibit 11

# FINISAR CORP

## FORM 10-Q (Quarterly Report)

Filed 12/04/07 for the Period Ending 10/29/06

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

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**Form 10-Q**

(Mark One)

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the Quarterly Period Ended October 29, 2006**

or

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from** \_\_\_\_\_ **to** \_\_\_\_\_

**Commission file number 000-27999**

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**Finisar Corporation**

*(Exact name of Registrant as specified in its charter)*

**Delaware**

*(State or other jurisdiction of  
incorporation or organization)*

**1389 Moffett Park Drive**

**Sunnyvale, California**

*(Address of principal executive offices)*

**94-3038428**

*(I.R.S. Employer  
Identification No.)*

**94089**

*(Zip Code)*

**Registrant's telephone number, including area code:**

**408-548-1000**

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☐ No ☒

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☒ Accelerated filer ☐ Non-accelerated filer ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

At November 30, 2007, there were 308,634,829 shares of the registrant's common stock, \$.001 par value, issued and outstanding.

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**For the Quarter Ended October 29, 2006**

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## FORWARD LOOKING STATEMENTS

This report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. We use words like “anticipates,” “believes,” “plans,” “expects,” “future,” “intends” and similar expressions to identify these forward-looking statements. We have based these forward-looking statements on our current expectations and projections about future events; however, our business and operations are subject to a variety of risks and uncertainties, and, consequently, actual results may materially differ from those projected by any forward-looking statements. As a result, you should not place undue reliance on these forward-looking statements since they may not occur.

Certain factors that could cause actual results to differ from those projected are discussed in “Item 1A. Risk Factors.” We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information or future events.

## EXPLANATORY NOTE

In this quarterly report on Form 10-Q for the three and six months ended October 29, 2006, Finisar Corporation is restating its condensed consolidated balance sheet as of April 30, 2006, the related condensed consolidated statements of operations for the three and six months ended October 30, 2005 and the related condensed consolidated statement of cash flows for the six months ended October 30, 2005 as a result of an investigation commenced by the Audit Committee of our Board of Directors. This restatement is more fully described in “Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations” and in Note 2, “Restatement of Consolidated Financial Statements,” of the Notes to the Consolidated Financial Statements. In our annual report on Form 10-K for the fiscal year ended April 30, 2007, we are restating our consolidated balance sheet as of April 30, 2006 and the related statements of operations, stockholder’s equity, and cash flows for the fiscal years ended April 30, 2006 and April 30, 2005, as well as the “Selected Consolidated Financial Data” for the fiscal years ended April 30, 2006, April 30, 2005, April 30, 2004 and April 30, 2003 as set forth in Item 6 of the Form 10-K report and unaudited quarterly financial information and financial statements for the interim periods of fiscal 2006 and the three months ended July 29, 2007 contained therein.

The table below reflects the impact, by year, of the restatement:

Fiscal Year Ended	Restatement Adjustments						
	Gross Stock-Based Compensation Charge	Stock-Based Compensation Capitalized to Inventory	Net Stock-Based Compensation Charge	Payroll Tax Charge	Total Pre-Tax Charges	Income Tax (Benefit) Provision	After-Tax Non-Cash Charge
	(In thousands)						
April 30, 2000	\$ 5,416	\$ (124)	\$ 5,292	\$ 0	\$ 5,292	\$ (2,112)	\$ 3,180
April 30, 2001	27,160	(563)	26,597	175	26,772	(10,906)	15,866
April 30, 2002	31,780	(568)	31,212	22	31,234	13,018	44,252
April 30, 2003	24,482	835	25,317	3	25,320	—	25,320
April 30, 2004	13,087	72	13,159	(14)	13,145	—	13,145
Cumulative Effect at April 30, 2004	101,925	(348)	101,577	186	101,763	—	101,763
April 30, 2005	3,440	236	3,676	(55)	3,621	—	3,621
April 30, 2006	7,303	(484)	6,819	1,425	8,244	(134)	8,110
Total	<u>\$ 112,668</u>	<u>\$ (596)</u>	<u>\$ 112,072</u>	<u>\$ 1,556</u>	<u>\$ 113,628</u>	<u>\$ (134)</u>	<u>\$ 113,494</u>

Financial information included in the Company’s reports on Form 10-K, Form 10-Q and Form 8-K filed by Finisar prior to November 28, 2006 and the related reports of its independent registered public accounting firm, included in the Forms 10-K, and all earnings and press releases and similar communications issued by the Company prior to November 28, 2006 should not be relied upon and are superseded in their entirety by the annual report on Form 10-K for the fiscal year ended April 30, 2007, this quarterly report on Form 10-Q and the other reports on Form 10-Q and Form 8-K filed by the Company with the Securities and Exchange Commission on or after November 28, 2006.

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## PART I — FINANCIAL INFORMATION

## Item 1. Financial Statements

**FINISAR CORPORATION**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
(in thousands, except per share amounts)

	October 29, 2006 (Unaudited)	April 30, 2006 As Restated (1)
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 58,544	\$ 63,361
Short-term available-for-sale investments	53,125	33,507
Restricted investments, short-term	1,250	3,705
Accounts receivable, net of allowance for doubtful accounts of \$1,665 and \$2,198 at October 29, 2006 and April 30, 2006	64,687	57,388
Accounts receivable, other	10,997	8,963
Inventories	58,674	53,570
Prepaid expenses	3,283	4,112
Total current assets	250,560	224,606
Long-term available-for-sale investments	26,722	21,918
Property, plant and improvements, net	80,962	82,225
Restricted investments, long-term	—	1,815
Purchased technology, net	11,949	14,972
Other purchased intangible assets, net	3,571	4,184
Goodwill	124,532	124,532
Minority investments	11,250	15,093
Other assets	17,712	17,125
Total assets	<u>\$ 527,258</u>	<u>\$ 506,470</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 37,507	\$ 34,221
Accrued compensation	11,649	10,932
Other accrued liabilities	12,994	13,129
Deferred revenue	4,862	5,070
Current portion of other long-term liabilities	2,233	2,333
Convertible notes	50,000	—
Non-cancelable purchase obligations	1,640	1,209
Total current liabilities	120,885	66,894
Long-term liabilities:		
Convertible notes, net of beneficial conversion feature of \$9,617 and \$11,975 at October 29, 2006 and April 30, 2006	190,633	238,275
Other long-term liabilities	19,959	21,253
Deferred income taxes	5,002	3,919
Total long-term liabilities	215,594	263,447
Commitments and contingent liabilities:		
Stockholders' equity:		
Preferred stock, \$0.001 par value, 5,000,000 shares authorized, no shares issued and outstanding at October 29, 2006 and April 30, 2006	—	—
Common stock, \$0.001 par value, 750,000,000 shares authorized, 308,290,494 shares issued and outstanding at October 29, 2006 and 305,512,111 shares issued and outstanding at April 30, 2006	308	306
Additional paid-in capital	1,523,436	1,487,464
Deferred stock compensation	—	(3,616)
Accumulated other comprehensive income	6,580	1,698
Accumulated deficit	(1,339,545)	(1,309,723)
Total stockholders' equity	190,779	176,129
Total liabilities and stockholders' equity	<u>\$ 527,258</u>	<u>\$ 506,470</u>

(1) See Note 2, "Restatement of Condensed Consolidated Financial Statements," to Condensed Consolidated Financial Statements.

See accompanying notes





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**FINISAR CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
(unaudited, in thousands, except share and per share data)

	Three Months Ended		Six Months Ended	
	October 29, 2006	October 30, 2005 As restated (1)	October 29, 2006	October 30, 2005 As restated (1)
Revenues				
Optical subsystems and components	\$ 99,009	\$ 77,449	\$ 195,052	\$ 149,819
Network test and monitoring systems	9,180	9,173	19,380	18,535
Total revenues	108,189	86,622	214,432	168,354
Cost of revenues	68,995	59,895	139,716	120,854
Impairment of acquired developed technology	—	853	—	853
Amortization of acquired developed technology	1,505	5,421	3,024	11,075
Gross profit	37,689	20,453	71,692	35,572
Operating expenses:				
Research and development	16,000	14,158	30,395	27,184
Sales and marketing	9,439	7,451	18,273	15,913
General and administrative	7,092	6,839	14,606	14,905
Amortization of purchased intangibles	313	453	612	929
Restructuring costs	—	3,064	—	3,064
Total operating expenses	32,844	31,965	63,886	61,995
Income (loss) from operations	4,845	(11,512)	7,806	(26,423)
Interest income	1,399	765	2,654	1,548
Interest expense	(3,900)	(3,830)	(7,821)	(7,917)
Loss on convertible debt exchange	(31,606)	—	(31,606)	—
Other income (expense), net	(440)	(821)	(810)	(1,421)
Loss before income taxes and cumulative effect of change in accounting principle	(29,702)	(15,398)	(29,777)	(34,213)
Provision for income taxes	627	657	1,258	1,251
Loss before cumulative effect of change in accounting principle	(30,329)	(16,055)	(31,035)	(35,464)
Cumulative effect of change in accounting principle, net of tax	—	—	(1,213)	—
Net loss	\$ (30,329)	\$ (16,055)	\$ (29,822)	\$ (35,464)
Net loss per share — basic and diluted:				
Before effect of change in accounting principle	\$ (0.10)	\$ (0.06)	\$ (0.10)	\$ (0.13)
Cumulative effect of change in accounting principle	\$ —	\$ —	\$ (0.00)	\$ —
Net loss	\$ (0.10)	\$ (0.06)	\$ (0.10)	\$ (0.13)
Shares used in computing net loss per share — basic and diluted	307,558	289,968	307,027	281,048

(1) See Note 2, "Restatement of Condensed Consolidated Financial Statements," to Condensed Consolidated Financial Statements.

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**FINISAR CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(unaudited, in thousands)

	Six Months Ended	
	October 29, 2006	October 30, 2005 As Restated(1)
<b>Operating activities</b>		
Net loss	\$ (29,822)	\$ (35,464)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	13,419	18,958
Stock-based compensation expense	6,570	546
Amortization of beneficial conversion feature of convertible notes	2,358	2,231
Amortization of purchased technology and other purchased intangibles	612	929
Amortization of acquired developed technology	3,024	11,076
Amortization of discount on restricted securities	(56)	(87)
Loss on sale or retirement of equipment	519	326
Share of losses of equity investee	237	1,039
Impairment of intangible assets	—	853
Loss on debt extinguishment	31,606	—
Changes in operating assets and liabilities:		
Accounts receivable	(7,299)	(2,244)
Inventories	(5,317)	(6,854)
Other assets	(5,103)	3,504
Deferred income taxes	1,088	1,236
Accounts payable	3,286	2,243
Accrued compensation	717	1,107
Other accrued liabilities	(329)	755
Deferred revenue	(208)	1,429
Net cash provided by operating activities	<u>15,302</u>	<u>1,583</u>
<b>Investing activities</b>		
Purchases of property, equipment and improvements	(11,202)	(8,968)
Proceeds from sale of property and equipment	107	153
Sale (purchase) of short-term and long-term investments	(15,677)	10,241
Maturity of restricted securities	4,326	1,875
Acquisition of subsidiaries, net of cash assumed	—	(1,213)
Net cash (used in) provided by investing activities	<u>(22,446)</u>	<u>2,088</u>
<b>Financing activities</b>		
Repayments of liability related to sale-leaseback of building	(141)	(115)
Repayments of borrowings	(1,064)	(195)
Proceeds from exercise of stock options and employee stock purchase plan	3,532	373
Net cash provided by financing activities	<u>2,327</u>	<u>63</u>
Net increase (decrease) in cash and cash equivalents	(4,817)	3,734
Cash and cash equivalents at beginning of period	63,361	29,431
Cash and cash equivalents at end of period	<u>\$ 58,544</u>	<u>\$ 33,165</u>
<b>Supplemental disclosure of cash flow information</b>		
Cash paid for interest	\$ 4,770	\$ 4,528
Cash paid for taxes	\$ 98	\$ (13)
<b>Supplemental schedule of non-cash investing and financing activities</b>		
Issuance of common stock upon conversion of promissory notes	\$ —	\$ 32,474
Issuance of common stock in connection with acquisitions	<u>\$ —</u>	<u>\$ 8,815</u>

(1) See Note 2, "Restatement of Condensed Consolidated Financial Statements," to Condensed Consolidated Financial Statements.

See accompanying notes.



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**(unaudited)****1. Summary of Significant Accounting Policies*****Description of Business***

Finisar Corporation is a leading provider of optical subsystems and components that connect local area networks, or LANs, storage area networks, or SANs, and metropolitan area networks, or MANs. Our optical subsystems consist primarily of transceivers which provide the fundamental optical-electrical interface for connecting the equipment used in building these networks. These products rely on the use of digital semiconductor lasers in conjunction with integrated circuit design and novel packaging technology to provide a cost-effective means for transmitting and receiving digital signals over fiber optic cable using a wide range of network protocols, transmission speeds and physical configurations over distances of 70 meters to 200 kilometers. Our line of optical components consists primarily of packaged lasers and photodetectors used in transceivers, primarily for LAN and SAN applications. Our manufacturing operations are vertically integrated and include internal manufacturing, assembly and test capability. We sell our optical subsystem and component products to manufacturers of storage and networking equipment such as Brocade, Cisco Systems, EMC, Emulex, Hewlett-Packard Company, Huawei and Qlogic.

We also provide network performance test and monitoring systems to original equipment manufacturers for testing and validating equipment designs and, to a lesser degree, to operators of networking and storage data centers for testing, monitoring and troubleshooting the performance of their installed systems. We sell these products primarily to leading storage equipment manufacturers such as Brocade, EMC, Emulex, Hewlett-Packard Company, IBM and Qlogic.

Finisar Corporation was incorporated in California in April 1987 and reincorporated in Delaware in November 1999. Finisar's principal executive offices are located at 1389 Moffett Park Drive, Sunnyvale, California 94089, and its telephone number at that location is (408) 548-1000.

***Interim Financial Information and Basis of Presentation***

The accompanying unaudited condensed consolidated financial statements as of October 29, 2006, and for the three and six month periods ended October 29, 2006 and October 30, 2005 (as restated), have been prepared in accordance with U.S generally accepted accounting principles for interim financial statements and pursuant to the rules and regulations of the Securities and Exchange Commission, and include the accounts of Finisar Corporation and its wholly-owned subsidiaries (collectively, "Finisar" or the "Company"). Inter-company accounts and transactions have been eliminated in consolidation. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. In the opinion of management, the unaudited condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of the Company's financial position at October 29, 2006 and its operating results and cash flows for the three and six month periods ended October 29, 2006 and October 30, 2005 (as restated). These unaudited condensed consolidated financial statements should be read in conjunction with the Company's audited financial statements and notes for the fiscal year ended April 30, 2007.

***Fiscal Periods***

The Company maintains its financial records on the basis of a fiscal year ending on April 30, with fiscal quarters ending on the Sunday closest to the end of the period (thirteen-week periods).

***Use of Estimates***

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from these estimates.

***Stock-Based Compensation Expense***

On May 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123(revised 2004), *Share-Based Payment* ("SFAS 123(R)"), which requires the measurement and recognition of compensation expense for all share-based payment



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awards made to employees and directors including employee stock options and employee stock purchases related to the Employee Stock Purchase Plan ("employee stock purchases") based on estimated fair values. SFAS 123(R) supersedes the Company's previous accounting under Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* ("APB 25") for periods beginning in fiscal 2007. In March 2005, the SEC issued Staff Accounting Bulletin No. 107 ("SAB 107") relating to SFAS 123(R). The Company has applied the provisions of SAB 107 in its adoption of SFAS 123(R).

The Company adopted SFAS 123(R) using the modified-prospective-transition method, which requires the application of the accounting standard as of May 1, 2006, the first day of the Company's 2007 fiscal year. The Company's condensed consolidated financial statements as of and for the three and six months ended October 29, 2006 reflect the impact of SFAS 123(R). In accordance with the modified-prospective-transition method, the Company's condensed consolidated financial statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS 123(R). Stock-based compensation expense recognized under SFAS 123(R) for the three and six months ended October 29, 2006 was \$3.1 million and \$6.6 million, respectively, which consisted of stock-based compensation expense related to employee stock options and employee stock purchases. Stock-based compensation expense recognized under APB 25 for the three and six months ended October 30, 2005, as restated, was \$293,000 and \$532,000, respectively, which consisted of stock-based compensation related to employee stock options and employee stock purchases. See Notes 2 and 10 for additional information. Upon the adoption of SFAS 123R on May 1, 2006, we recorded a \$1.2 million cumulative benefit from change in accounting principle, net of tax, reflecting the net cumulative impact of estimated forfeitures related to unvested stock options as of May 1, 2006 that were previously not included in the determination of historic stock-based compensation expense under APB 25 in periods prior to May 1, 2006.

SFAS 123(R) requires companies to estimate the fair value of share-based payment awards on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods in the Company's condensed consolidated statement of operations. Prior to the adoption of SFAS 123(R), the Company accounted for stock-based awards to employees and directors using the intrinsic value method in accordance with APB 25 as allowed under Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation* ("SFAS 123").

Stock-based compensation expense recognized during the period is based on the value of the portion of share-based payment awards that is ultimately expected to vest during the period. Stock-based compensation expense recognized in the Company's condensed consolidated statements of operations for the three and six months ended October 29, 2006 included compensation expense for share-based payment awards granted prior to, but not yet vested as of April 30, 2006 based on the grant date fair value estimated in accordance with the provisions of SFAS 123 and compensation expense for the share-based payment awards granted subsequent to April 30, 2006 based on the grant date fair value estimated in accordance with the provisions of SFAS 123(R). Compensation expense for all share-based payment awards granted prior to the adoption of SFAS 123(R) was recognized using the Black-Scholes option-pricing model with a graded-vesting multiple-option approach. Compensation expense for all share-based payment awards granted subsequent to adoption of SFAS 123(R) is recognized using the Black-Scholes option-pricing model with a straight-line single-option approach. As stock-based compensation expense recognized in the condensed consolidated statement of operations for the three and six months ended October 29, 2006 is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. SFAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. In the Company's pro forma information required under SFAS 123 for the periods prior to fiscal 2007, the Company accounted for forfeitures as they occurred.

The Black-Scholes option valuation model requires the input of highly subjective assumptions, including the expected life of the stock-based award and the stock price volatility. The assumptions represent management's best estimates, but these estimates involve inherent uncertainties and the application of management judgment. As a result, if other assumptions had been used, our recorded and pro forma stock-based compensation expense could have been materially different. In addition, we are required to estimate the expected forfeiture rate and only recognize expense for those shares expected to vest. If our actual forfeiture rate is materially different from our estimate, the stock-based compensation expense could be materially different.

On November 10, 2005, the Financial Accounting Standards Board ("FASB") issued FASB Staff Position No. FAS 123(R)-3 *Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards*. The Company has elected to adopt the alternative transition method provided in the FASB Staff Position for calculating the tax effects of stock-based compensation pursuant to SFAS 123(R). The alternative transition method includes simplified methods to establish the beginning balance of the additional paid-in capital pool ("APIC pool") related to the tax effects of employee stock-based compensation, and to determine the subsequent impact on the APIC pool and condensed consolidated statements of cash flows of the tax effects of employee stock-based compensation awards that are outstanding upon adoption of SFAS 123(R).

**Revenue Recognition**

The Company's revenue transactions consist predominately of sales of products to customers. The Company follows the Securities and Exchange Commission (SEC) Staff Accounting Bulletin (SAB) No. 104 *Revenue Recognition* and Emerging Issues Task Force

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("EITF") Issue 00-21 *Revenue Arrangements with Multiple Deliverables*. Specifically, the Company recognizes revenue when persuasive evidence of an arrangement exists, title and risk of loss have passed to the customer, generally upon shipment, the price is fixed or determinable, and collectability is reasonably assured. For those arrangements with multiple elements, or in related arrangements with the same customer, the arrangement is divided into separate units of accounting if certain criteria are met, including whether the delivered item has stand-alone value to the customer and whether there is objective and reliable evidence of the fair value of the undelivered items. The consideration received is allocated among the separate units of accounting based on their respective fair values, and the applicable revenue recognition criteria are applied to each of the separate units. In cases where there is objective and reliable evidence of the fair value of the undelivered item in an arrangement but no such evidence for the delivered item, the residual method is used to allocate the arrangement consideration. For units of accounting which include more than one deliverable, the Company generally recognizes all revenue and cost of revenue for the unit of accounting during the period in which the last undelivered item is delivered.

At the time revenue is recognized, the Company establishes an accrual for estimated warranty expenses associated with sales, recorded as a component of cost of revenues. The Company's customers and distributors generally do not have return rights. However, the Company has established an allowance for estimated customer returns, based on historical experience, which is netted against revenue.

Sales to certain distributors are made under agreements providing distributor price adjustments and rights of return under certain circumstances. Revenue and costs relating to distributor sales are deferred until products are sold by the distributors to end customers. Revenue recognition depends on notification from the distributor that product has been sold to the end customer. Also reported by the distributor are product resale price, quantity and end customer shipment information, as well as inventory on hand. Deferred revenue on shipments to distributors reflects the effects of distributor price adjustments and, the amount of gross margin expected to be realized when distributors sell-through products purchased from the Company. Accounts receivable from distributors are recognized and inventory is relieved when title to inventories transfers, typically upon shipment from the Company at which point the Company has a legally enforceable right to collection under normal payment terms.

**Segment Reporting**

Statement of Financial Accounting Standards (SFAS) No. 131 *Disclosures about Segments of an Enterprise and Related Information* establishes standards for the way that public business enterprises report information about operating segments in annual financial statements and requires that those enterprises report selected information about operating segments in interim financial reports. SFAS 131 also establishes standards for related disclosures about products and services, geographic areas and major customers. The Company has determined that it operates in two segments consisting of optical subsystems and components and network test and monitoring systems.

**Concentrations of Credit Risk**

Financial instruments which potentially subject Finisar to concentrations of credit risk include cash, cash equivalents, available-for-sale and restricted investments and accounts receivable. Finisar places its cash, cash equivalents, available-for-sale and restricted investments with high-credit quality financial institutions. Such investments are generally in excess of FDIC insurance limits. Concentrations of credit risk, with respect to accounts receivable, exist to the extent of amounts presented in the financial statements. Generally, Finisar does not require collateral or other security to support customer receivables. Finisar performs periodic credit evaluations of its customers and maintains an allowance for potential credit losses based on historical experience and other information available to management. Losses to date have not been material. The Company's five largest customers represented 46.3% and 34.7% of total accounts receivable at October 29, 2006 and April 30, 2006, respectively.

**Current Vulnerabilities Due to Certain Concentrations**

Finisar sells products primarily to customers located in North America. During the three and six months ended October 29, 2006, sales to the top five customers represented 45.9% and 44.9% of total revenues, respectively. During the three and six months ended October 30, 2005, sales to the top five customers represented 47.0% and 47.6% of total revenues, respectively. One customer represented more than 10% of total revenues during each of these periods.

Included in the Company's condensed consolidated balance sheet at October 29, 2006, are the net assets of the Company's manufacturing operations, substantially all of which are located in Malaysia and which total approximately \$52.1 million.

**Foreign Currency Translation**

The functional currency of the Company's foreign subsidiaries is the local currency. Assets and liabilities denominated in foreign currencies are translated using the exchange rate on the balance sheet dates. Revenues and expenses are translated using average

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exchange rates prevailing during the year. Any translation adjustments resulting from this process are shown separately as a component of accumulated other comprehensive income. Foreign currency transaction gains and losses are included in the determination of net loss.

***Research and Development***

Research and development expenditures are charged to operations as incurred.

***Advertising Costs***

Advertising costs are expensed as incurred. Advertising is used infrequently in marketing the Company's products. Advertising costs were \$24,500 and \$33,000 in the three and six months ended October 29, 2006, respectively and \$64,000 and \$193,000 in the three and six months ended October 30, 2005, respectively.

***Shipping and Handling Costs***

The Company records costs related to shipping and handling in cost of sales for all periods presented.

***Cash and Cash Equivalents***

Finisar's cash equivalents consist of money market funds and highly liquid short-term investments with qualified financial institutions. Finisar considers all highly liquid investments with an original maturity from the date of purchase of three months or less to be cash equivalents.

***Investments******Available-for-Sale***

Available-for-sale investments consist of interest bearing securities with maturities of greater than three months from the date of purchase and equity securities. Pursuant to SFAS No. 115 *Accounting for Certain Investments in Debt and Equity Securities*, the Company has classified its investments as available-for-sale. Available-for-sale securities are stated at market value, which approximates fair value, and unrealized holding gains and losses, net of the related tax effect, are excluded from earnings and are reported as a separate component of accumulated other comprehensive income until realized. A decline in the market value of the security below cost that is deemed other than temporary is charged to earnings, resulting in the establishment of a new cost basis for the security.

***Restricted Investments***

Restricted investments consist of interest bearing securities with maturities of greater than three months from the date of purchase and investments held in escrow under the terms of the Company's convertible subordinated notes. In accordance with SFAS 115, the Company has classified its restricted investments as held-to-maturity. Held-to-maturity securities are stated at amortized cost.

***Other***

The Company uses the cost method of accounting for investments in companies that do not have a readily determinable fair value in which it holds an interest of less than 20% and over which it does not have the ability to exercise significant influence. For entities in which the Company holds an interest of greater than 20% or in which the Company does have the ability to exercise significant influence, the Company uses the equity method. In determining if and when a decline in the market value of these investments below their carrying value is other-than-temporary, the Company evaluates the market conditions, offering prices, trends of earnings and cash flows, price multiples, prospects for liquidity and other key measures of performance. The Company's policy is to recognize an impairment in the value of its minority equity investments when clear evidence of an impairment exists, such as (a) the completion of a new equity financing that may indicate a new value for the investment, (b) the failure to complete a new equity financing arrangement after seeking to raise additional funds or (c) the commencement of proceedings under which the assets of the business may be placed in receivership or liquidated to satisfy the claims of debt and equity stakeholders. The Company's minority investments in private companies are generally made in exchange for preferred stock with a liquidation preference that is intended to help protect the underlying value of its investment.

**Table of Contents*****Fair Value of Financial Instruments***

The carrying amounts of certain of the Company's financial instruments, including cash and cash equivalents, accounts receivable, accounts payable, accrued compensation and other accrued liabilities, approximate fair value because of their short maturities. As of October 29, 2006 and April 30, 2006, the fair value of the Company's convertible subordinated debt was approximately \$287.6 million and \$323.0 million, respectively.

***Inventories***

Inventories are stated at the lower of cost (determined on a first-in, first-out basis) or market.

The Company permanently writes down the cost of inventory that the Company specifically identifies and considers obsolete or excessive to fulfill future sales estimates. The Company defines obsolete inventory as inventory that will no longer be used in the manufacturing process. Excess inventory is generally defined as inventory in excess of projected usage and is determined using management's best estimate of future demand, based upon information then available to the Company. The Company also considers: (1) parts and subassemblies that can be used in alternative finished products, (2) parts and subassemblies that are likely to be engineered out of the Company's products, and (3) known design changes which would reduce the Company's ability to use the inventory as planned.

***Property and Equipment***

Property and equipment are stated at cost, net of accumulated depreciation and amortization. Property and equipment are depreciated on a straight-line basis over the estimated useful lives of the assets, generally three years to seven years except for buildings, which are depreciated over 40 years. Land is carried at acquisition cost and not depreciated. Leased land costs are depreciated over the life of the lease.

***Goodwill and Other Intangible Assets***

Goodwill and other intangible assets result from acquisitions accounted for under the purchase method. Amortization of intangibles has been provided on a straight-line basis over periods ranging from one to nine years. The amortization of goodwill ceased with the adoption of SFAS No. 142 beginning in the first quarter of fiscal 2003.

***Accounting for the Impairment of Long-Lived Assets***

The Company periodically evaluates whether changes have occurred to long-lived assets that would require revision of the remaining estimated useful life of the assets or render them not recoverable. If such circumstances arise, the Company uses an estimate of the undiscounted value of expected future operating cash flows to determine whether the long-lived assets are impaired. If the aggregate undiscounted cash flows are less than the carrying amount of the assets, the resulting impairment charge to be recorded is calculated based on the excess of the carrying value of the assets over the fair value of such assets, with the fair value determined based on an estimate of discounted future cash flows.

***Computation of Net Loss Per Share***

Basic and diluted net loss per share is presented in accordance with SFAS No. 128 *Earnings Per Share* for all periods presented. Basic net loss per share has been computed using the weighted-average number of shares of common stock outstanding during the period. Diluted net loss per share has been computed using the weighted-average number of shares of common stock and dilutive potential common shares from options and warrants (under the treasury stock method) and convertible notes (on an as-if-converted basis) outstanding during the period.



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The following table presents the calculation of basic and diluted net loss per share (in thousands, except per share amounts):

	Three Months Ended		Six Months Ended	
	October 29, 2006	October 30, 2005	October 29, 2006	October 30, 2005
	As restated (1) (in thousands, except per share amounts)		As restated (1)	
Numerator:				
Net loss	\$ (30,329)	\$ (16,055)	\$ (29,822)	\$ (35,464)
Denominator for basic net loss per share:				
Weighted-average shares outstanding — total	307,558	289,968	307,027	281,048
Weighted-average shares outstanding — basic	307,558	289,968	307,027	281,048
Basic and diluted net loss per share	\$ (0.10)	\$ (0.06)	\$ (0.10)	\$ (0.13)
Common stock equivalents related to potentially dilutive securities excluded from computation above because they are anti-dilutive:				
Employee stock options	15,401	1,569	16,233	1,507
Conversion of convertible subordinated notes	35,263	58,647	35,263	58,647
Conversion of convertible notes	—	749	—	749
Warrants	470	942	470	942
Potentially dilutive securities	51,134	61,907	51,966	61,845

(1) See Note 2, "Restatement of Condensed Consolidated Financial Statements," to Condensed Consolidated Financial Statements.

**Comprehensive Loss**

SFAS No. 130 *Reporting Comprehensive Income* establishes rules for reporting and display of comprehensive income and its components. SFAS No. 130 requires unrealized gains or losses on the Company's available-for-sale securities and foreign currency translation adjustments to be included in comprehensive income.

The components of comprehensive loss for the three and six months ended October 29, 2006 and October 30, 2005 were as follows (in thousands):

	Three Months Ended		Six Months Ended	
	October 29, 2006	October 30, 2005	October 29, 2006	October 30, 2005
	As restated (1) (in thousands)		As restated (1)	
Net loss	\$ (30,329)	\$ (16,055)	\$ (29,822)	\$ (35,464)
Foreign currency translation adjustment	330	(27)	(255)	(5)
Change in unrealized gain (loss) on securities, net of reclassification adjustments for realized loss	(6,845)	(69)	5,140	(192)
Comprehensive loss	\$ (36,844)	\$ (16,151)	\$ (24,937)	\$ (35,661)

(1) See Note 2, "Restatement of Condensed Consolidated Financial Statements," to Condensed Consolidated Financial Statements.

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The components of accumulated other comprehensive income, net of taxes, were as follows (in thousands):

	October 29, 2006	April 30, 2006
Net unrealized gains/(losses) on available-for-sale securities	\$ 4,564	\$ (576)
Cumulative translation adjustment	2,018	2,274
Accumulated other comprehensive income	<u>\$ 6,582</u>	<u>\$ 1,698</u>

**2. Restatement of Condensed Consolidated Financial Statements**

The Audit Committee of the Board of Directors ("Audit Committee") has completed a review of the Company's stock option granting practices and accounting. Based on the results of this review, the Company concluded that the accounting measurement dates under Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* ("APB 25"), for certain stock option grants awarded made from the date of the Company's initial public offering on November 11, 1999 through September 8, 2006 (the "Review Period") differ from the measurement dates previously used to determine any share-based compensation expense during the seven fiscal years ended April 30, 2006.

***Restatement of Previously Issued Financial Statements***

In this quarterly report on Form 10-Q for the three and six months ended October 29, 2006, Finisar Corporation is restating its condensed consolidated balance sheet as of April 30, 2006, the related consolidated statements of operations for the three and six months ended October 30, 2005, and the related condensed consolidated statement of cash flows for the six months ended October 30, 2005 as a result of an independent investigation of its historical stock option grants conducted by the Audit Committee of its Board of Directors. In the Company's annual report on Form 10-K for the fiscal year ended April 30, 2007 to be filed with the SEC (the "2007 Form 10-K"), the Company is restating its consolidated balance sheet as of April 30, 2006, and the related statements of operations, shareholders' equity, and cash flows for each of the fiscal years ended April 30, 2006 and 2005, as well as the "Selected Consolidated Financial Data" for the fiscal years ended April 30, 2006, April 30, 2005, April 30, 2004 and April 30, 2003, as set forth in Item 6 of the 2007 Form 10-K. In addition, the Company is restating its unaudited quarterly financial information and financial statements for the interim periods of 2006 and the three months ended July 30, 2006.

On November 28, 2006 the Company filed a current report on Form 8-K indicating that financial information included in the Company's reports on Form 10-K, Form 10-Q and Form 8-K filed by Finisar with the SEC prior to November 28, 2006, and the related reports of its independent registered public accounting firm included in the previously-filed Forms 10-K, and all earnings and press releases and similar communications issued by the Company prior to November 28, 2006, should not be relied upon and are superseded in their entirety by the 2007 Form 10-K, this quarterly report on Form 10-Q, and other reports on Forms 10-Q and Forms 8-K filed by the Company with the Securities and Exchange Commission on or after November 28, 2006. The Company also informed the staff of the Securities and Exchange Commission of the commencement of the investigation into its historical stock option granting practices and related accounting.

***Background of the Audit Committee Investigation***

In late August 2006, the Company's management commenced a preliminary internal review of certain of the Company's historical stock options granted since the Company's initial public offering on November 11, 1999. The review was voluntarily initiated by the Company due to widespread media attention concerning the stock option grant practices of many companies and was not in response to a news report or an investigation concerning Finisar by the Securities and Exchange Commission or any other governmental agency. After management's report on the results of this initial review, the Audit Committee directed management to conduct a further analysis of certain stock option grants. Thereafter, management reviewed documentation and materials regarding additional option grants and, in early November 2006, identified potential issues with respect to certain annual grants to employees. As a result, the Audit Committee determined that it should undertake a more comprehensive investigation of the Company's historical practices for granting and accounting for stock options during the Review Period. The Audit Committee's investigation was conducted with the assistance of independent counsel and forensic accountants.

The scope of the Audit Committee's investigation was extensive, and included the review of approximately 95% of all stock option grants during the Review Period. At the conclusion of the investigation, a working group was formed to address the accounting implications of the results of the investigation, and in the course of their analysis, the working group reviewed all additional grants made during the Review Period. In addition, the investigation involved testing and analyses of the Company's hiring, termination, leave of absence, and grant notification practices regarding stock options during the Review Period.

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## Findings

Based on the results of the investigation, the Company found evidence that it previously used incorrect measurement dates when accounting for stock option grants pursuant to Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, or APB 25, and related interpretations. The Company concluded that revised measurement dates are required for approximately 71% of the stock option grants awarded during the Review Period, consisting of options to purchase approximately 75.9 million shares of common stock. Revising option grant measurement dates resulted in total additional stock-based compensation charges of \$107.6 million to be recognized in the fiscal years 2000 through 2006. Approximately 85% of this total additional stock-based compensation expense, or \$91.1 million, is attributable to six key Granting Actions that occurred between June 2000 and August 2003, representing approximately 21 million shares, or 20% of all options granted during the Review Period. Three of these six key Granting Actions were performance grants, and three were New Hire grants, as such grant types are defined below. The Audit Committee determined that the incorrect measurement dates were the result of process-related deficiencies and that the individuals involved in the option granting process lacked a thorough understanding of the relevant accounting rules. The Audit Committee found no evidence of intentional misconduct or malfeasance on the part of the Company personnel involved in selecting and approving the grant dates or administering the stock option granting process.

The reasons for the revised measurement dates varied with the particular facts and circumstances of each affected grant. Specifically, in the case of grants which were approved pursuant to the authority delegated to the CEO as the Stock Plan Committee, the Audit Committee found process-related deficiencies. These deficiencies resulted in the Company erroneously treating the stated grant date as the measurement date for financial accounting purposes. The grants in this category included performance grants, grants to newly-hired employees and grants to employees hired in connection with acquisitions of other companies by us. The Audit Committee concluded that twelve performance grants either lacked contemporaneous evidence to verify the date selected or, in the case of two grants, were selected retrospectively to capture a more favorable price. The Audit Committee found that 86 grants to newly-hired employees lacked contemporaneous evidence of grant date selection. Additionally, the Audit Committee found that four grants to employees of acquired companies were measured on a date other than that specified in the acquisition agreements. In eight instances, a grant was properly approved on a grant date that was prior to the date the exercise price was set (at a price lower than the grant date) resulting in variable accounting. Finally, a grant to three of our officers, including a grant to our CFO, was erroneously included in a large, broad-based performance grant by the Stock Plan Committee in June 2000. The Audit Committee has not located conclusive evidence that the three officer grants were separately approved by the Board or Directors or the Compensation Committee; however, the Audit Committee considers the option grants to be a valid obligation of the Company.

In addition, the Company identified modifications to certain stock options related to extended leaves of absence that should have been accounted for by applying modification accounting as required by the provisions of FASB Interpretation No. 44, *Accounting for Certain Transactions Involving Stock Compensation*, or FIN 44. This resulted in \$5.1 million of additional stock-based compensation expense, of which \$5.0 million is attributable to one leave of absence. Therefore, as a result of the investigation, the Company identified a total of \$112.7 million in additional pre-tax, non-cash, stock-based compensation charges for the fiscal years 2000 through 2006, prior to the consideration of any amounts related to inventory, and had approximately \$3.6 million of deferred stock-based compensation expense to be amortized to compensation expense as of April 30, 2006. On May 1, 2006, we adopted Statement of Financial Accounting Standards ("SFAS") No. 123 (revised 2004), "*Share-Based Payment*" ("SFAS 123R"). As required by SFAS 123R, the unamortized deferred compensation expense of \$3.6 million at May 1, 2006 has been reclassified to additional paid-in capital.

With respect to grants that the Company determined had been completed and later modified, the Company applied variable accounting in accordance with APB 25 and FASB Interpretation No. 44, *Accounting for Certain Transactions Involving Stock Compensation, an interpretation of APB Opinion No. 25* ("FIN 44").

## Summary of Stock-Based Compensation Adjustments

To reflect this previously unrecognized non-cash expense the Company has recognized additional share-based compensation expense and payroll tax expense, that has the overall effect of increasing the accumulated deficit, and common stock and additional paid-in capital. The table below reflects the impact, by year, of the restatement:

Fiscal Year Ended	Restatement Adjustments						
	Gross Stock-Based Compensation Charge	Stock-Based Compensation Capitalized to Inventory	Net Stock-Based Compensation Charge	Payroll Tax Charge	Total Pre-Tax Charges	Income Tax (Benefit) Provision	After-Tax Non-Cash Charge
	(In thousands)						
April 30, 2000	\$ 5,416	\$ (124)	\$ 5,292	\$ 0	\$ 5,292	\$ (2,112)	\$ 3,180
April 30, 2001	27,160	(563)	26,597	175	26,772	(10,906)	15,866
April 30, 2002	31,780	(568)	31,212	22	31,234	13,018	44,252
April 30, 2003	24,482	835	25,317	3	25,320	—	25,320
April 30, 2004	13,087	72	13,159	(14)	13,145	—	13,145
Cumulative Effect at							
April 30, 2004	101,925	(348)	101,577	186	101,763	—	101,763
April 30, 2005	3,440	236	3,676	(55)	3,621	—	3,621
April 30, 2006	7,303	(484)	6,819	1,425	8,244	(134)	8,110
Total	\$ 112,668	\$ (596)	\$ 112,072	\$ 1,556	\$ 113,628	\$ (134)	\$ 113,494





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The cumulative effect of share-based compensation pre-tax adjustments was to increase additional paid-in capital by \$112.3 million and to increase accumulated deficit by \$101.8 million on the Company's consolidated balance sheet as of April 30, 2004. The restatement had no impact on the Company's previously reported cash flows or revenues.

*Effects of the Restatement Adjustments*

The following table presents the effect of the stock-based compensation and related tax adjustments upon the Company's previously reported condensed consolidated balance sheet as of April 30, 2006 (in thousands):

	April 30, 2006		
	As Previously Reported	Adjustments	As Restated
<b>ASSETS</b>			
Current assets:			
Cash and cash equivalents	\$ 63,361	\$ —	\$ 63,361
Short-term investments	33,507	—	33,507
Restricted investments, short-term	3,705	—	3,705
Accounts receivable, net of allowances	57,388	—	57,388
Accounts receivable, other	8,963	—	8,963
Inventories	52,974	596	53,570
Prepaid expenses	4,112	—	4,112
Total current assets	224,010	596	224,606
Long-term investments	21,918	—	21,918
Property, plant and improvements, net	82,225	—	82,225
Restricted investments, long-term	1,815	—	1,815
Purchased technology, net	14,972	—	14,972
Other purchased intangible assets, net	4,184	—	4,184
Goodwill, net	124,532	—	124,532
Minority investments	15,093	—	15,093
Other assets	17,125	—	17,125
Total assets	<u>\$ 505,874</u>	<u>\$ 596</u>	<u>\$ 506,470</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>			
Current liabilities:			
Accounts payable	\$ 34,221	\$ —	\$ 34,221
Accrued compensation	9,376	1,556	10,932
Other accrued liabilities	13,129	—	13,129
Deferred revenue	5,070	—	5,070
Current portion of other long-term liabilities	2,333	—	2,333
Non-cancelable purchase obligations	1,209	—	1,209
Total current liabilities	65,338	1,556	66,894
Long-term liabilities:			
Convertible notes	238,275	—	238,275
Other long-term liabilities	21,253	—	21,253
Deferred income taxes	4,053	(134)	3,919
Total long-term liabilities	263,581	(134)	263,447
Stockholders' equity:			
Preferred stock	—	—	—
Common stock	306	—	306
Additional paid-in capital	1,371,180	116,284	1,487,464
Deferred stock compensation	—	(3,616)	(3,616)
Accumulated other comprehensive income	1,698	—	1,698
Accumulated deficit	(1,196,229)	(113,494)	(1,309,723)
Total stockholders' equity	176,955	(826)	176,129
Total liabilities and stockholders' equity	<u>\$ 505,874</u>	<u>\$ 596</u>	<u>\$ 506,470</u>

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The following table presents the effect of the stock-based compensation and related tax adjustments upon the Company's previously reported condensed consolidated statements of operations (in thousands, except per share data):

	Three Months Ended October 30, 2005			Six Months Ended October 30, 2005		
	As Previously Reported	Adjustment	As Restated	As Previously Reported	Adjustment	As Restated
<b>Statement of Operations Data</b>						
Revenues:						
Optical subsystems and components	\$ 77,449	—	\$ 77,449	\$ 149,819	—	\$ 149,819
Network test and monitoring systems	9,173	—	9,173	18,535	—	18,535
Total revenues	86,622	—	86,622	168,354	—	168,354
Cost of revenues	59,698	197	59,895	120,489	365	120,854
Impairment of acquired developed technology	853	—	853	853	—	853
Amortization of acquired developed technology	5,421	—	5,421	11,075	—	11,075
Gross profit (loss)	20,650	(197)	20,453	35,937	(365)	35,572
Operating expenses:						
Research and development	14,141	17	14,158	27,162	22	27,184
Sales and marketing	7,501	(50)	7,451	15,872	41	15,913
General and administrative	6,768	71	6,839	14,777	128	14,905
Amortization of purchased intangibles	453	—	453	929	—	929
Restructuring costs	3,064	—	3,064	3,064	—	3,064
Total operating expenses	31,927	38	31,965	61,804	191	61,995
Loss from operations	(11,277)	(235)	(11,512)	(25,867)	(556)	(26,423)
Interest income	765	—	765	1,548	—	1,548
Interest expense	(3,830)	—	(3,830)	(7,917)	—	(7,917)
Other income (expense), net	(821)	—	(821)	(1,421)	—	(1,421)
Loss before income taxes	(15,163)	(235)	(15,398)	(33,657)	(556)	(34,213)
Provision for income taxes	657	—	657	1,251	—	1,251
Net loss	\$ (15,820)	\$ (235)	\$ (16,055)	\$ (34,908)	\$ (556)	\$ (35,464)
Net loss per share	\$ (0.05)	\$ (0.00)	\$ (0.06)	\$ (0.12)	\$ (0.00)	\$ (0.13)
Shares used in computing net loss per share — basic and diluted	289,968	289,968	289,968	281,048	281,048	281,048

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The following table presents the effects of the restatement adjustments on the Company's previously reported condensed consolidated statements of cash flows (in thousands):

	Six Months Ended October 30, 2005		
	As Reported	Adjustment	As Restated
<b>Operating activities</b>			
Net loss	\$ (34,908)	\$ (556)	\$ (35,464)
Adjustments to reconcile net loss to net cash provided by operating activities:			
Depreciation and amortization	18,958	—	18,958
Stock-based compensation expense	—	546	546
Amortization of beneficial conversion feature of convertible notes	2,231	—	2,231
Amortization of purchased technology and other purchased intangibles	929	—	929
Amortization of acquired developed technology	11,076	—	11,076
Amortization of discount on restricted securities	(87)	—	(87)
Gain on sale or retirement of equipment	326	—	326
Share of losses of equity investee	1,039	—	1,039
Impairment of intangible assets	853	—	853
Changes in operating assets and liabilities:			
Accounts receivable	(2,244)	—	(2,244)
Inventories	(6,854)	—	(6,854)
Other assets	3,504	—	3,504
Deferred income taxes	1,236	—	1,236
Accounts payable	2,243	—	2,243
Accrued compensation	1,097	10	1,107
Other accrued liabilities	755	—	755
Deferred revenue	1,429	—	1,429
Net cash provided by operating activities	<u>1,583</u>	<u>—</u>	<u>1,583</u>
<b>Investing activities</b>			
Purchases of property, equipment and improvements	(8,968)	—	(8,968)
Proceeds from sale of property and equipment	153	—	153
Sale (purchase) of short-term and long-term investments	10,241	—	10,241
Maturity of restricted securities	1,875	—	1,875
Acquisition of subsidiaries, net of cash assumed	(1,213)	—	(1,213)
Net cash provided by investing activities	<u>2,088</u>	<u>—</u>	<u>2,088</u>
<b>Financing activities</b>			
Repayments of liability related to sale-leaseback of building	(115)	—	(115)
Repayments of borrowings	(195)	—	(195)
Proceeds from exercise of stock options and employee stock purchase plan	373	—	373
Net cash provided by (used in) financing activities	<u>63</u>	<u>—</u>	<u>63</u>
Net increase (decrease) in cash and cash equivalents	3,734	—	3,734
Cash and cash equivalents at beginning of period	29,431	—	29,431
Cash and cash equivalents at end of period	<u>\$ 33,165</u>	<u>\$ —</u>	<u>\$ 33,165</u>

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The following table presents the effect of the related adjustments on the pro forma calculation of the net income and net income per share for the three and six months ended October 30, 2005, respectively (in thousands, except per share amounts):

	Three Months Ended October 30, 2005			Six Months Ended October 30, 2005		
	As Previously Reported	Adjustment	As Restated	As Previously Reported	Adjustment	As Restated
Net loss	\$ (15,820)	\$ (235)	\$ (16,055)	\$ (34,908)	\$ (556)	\$ (35,464)
Add:						
APB 25 stock-based compensation expense, included in net loss, net of tax	—	230	230	—	546	546
Less:						
Stock-based compensation expense determined under fair value based method, net of tax	(1,905)	305	(1,600)	(4,572)	938	(3,634)
Pro forma net loss	<u>\$ (17,725)</u>	<u>\$ 300</u>	<u>\$ (17,425)</u>	<u>\$ (39,480)</u>	<u>\$ 928</u>	<u>\$ (38,552)</u>
Net loss per share — basic and diluted:						
As reported	<u>\$ (0.05)</u>	<u>\$ 0.00</u>	<u>\$ (0.06)</u>	<u>\$ (0.12)</u>	<u>\$ (0.00)</u>	<u>\$ (0.13)</u>
Pro forma	<u>\$ (0.06)</u>	<u>\$ 0.00</u>	<u>\$ (0.06)</u>	<u>\$ (0.14)</u>	<u>\$ 0.00</u>	<u>\$ (0.14)</u>
Shares used in computing reported and pro forma net loss — basic and diluted	289,968	289,968	289,968	281,048	281,048	281,048

## 3. Convertible Debt

The Company's convertible debt balances as of October 29, 2006 and April 30, 2006 are as follows (in thousands):

Description	Amount	Interest Rate	Due In Fiscal Year
<b>As of October 29, 2006</b>			
Convertible subordinated notes due 2008	\$100,250	5.25%	2009
Convertible subordinated notes due 2010	50,000	2.50%	2011
Convertible senior subordinated notes due 2010	100,000	2.50%	2011
	<u>\$250,250</u>		
<b>As of April 30, 2006</b>			
Convertible subordinated notes due 2008	\$100,250	5.25%	2009
Convertible subordinated notes due 2010	150,000	2.50%	2011
	<u>\$250,250</u>		

The Company's convertible subordinated and senior subordinated notes are due by fiscal year as follows (in thousands):

	Total	Fiscal Years Ended			
		2008	2009	2010	2011
Convertible notes	\$250,250	\$—	\$100,250	\$—	\$150,000

As of October 29, 2006 and April 30, 2006, the fair value of the Company's convertible subordinated debt was approximately \$287.6 million and \$323.0 million, respectively.



**Table of Contents*****Convertible Subordinated Notes due 2008***

On October 15, 2001, the Company sold \$125 million aggregate principal amount of 5 1 / 4 % convertible subordinated notes due October 15, 2008. Interest on the notes is 5 1 / 4 % per annum on the principal amount, payable semiannually on April 15 and October 15. The notes are convertible, at the option of the holder, at any time on or prior to maturity into shares of the Company's common stock at a conversion price of \$5.52 per share, which is equal to a conversion rate of approximately 181.159 shares per \$1,000 principal amount of notes. The conversion price is subject to adjustment. The notes may be redeemed by the Company for a cash payment of 100.75% of the principal amount together with accrued and unpaid interest.

Because the market value of the stock rose above the conversion price between the day the notes were priced and the day the proceeds were collected, the Company recorded a discount of \$38.3 million related to the intrinsic value of the beneficial conversion feature. This amount is being amortized to interest expense over the life of the convertible notes, or sooner upon conversion. During the three and six months ended October 29, 2006, the Company recorded interest expense amortization of \$1.2 million and \$2.4 million, respectively. During the three and six months ended October 30, 2005, the Company recorded interest expense amortization of \$1.1 million and \$2.2 million, respectively.

The notes are subordinated to all of the Company's existing and future senior indebtedness and effectively subordinated to all existing and future indebtedness and other liabilities of its subsidiaries. Because the notes are subordinated, in the event of bankruptcy, liquidation, dissolution or acceleration of payment on the senior indebtedness, holders of the notes will not receive any payment until holders of the senior indebtedness have been paid in full. The indenture does not limit the incurrence by the Company or its subsidiaries of senior indebtedness or other indebtedness.

Upon a change in control of the Company, each holder of the notes may require the Company to repurchase some or all of the notes at a purchase price equal to 100% of the principal amount of the notes plus accrued and unpaid interest. Instead of paying the change of control purchase price in cash the Company may, at its option, pay it in shares of the Company's common stock valued at 95% of the average of the closing sales prices of its common stock for the five trading days immediately preceding and including the third trading day prior to the date the Company is required to repurchase the notes. The Company cannot pay the change in control purchase price in common stock unless the Company satisfies the conditions described in the indenture under which the notes have been issued.

The notes are represented by one or more global notes, deposited with the trustee as custodian for The Depository Trust Company, or DTC, and registered in the name of Cede & Co., DTC's nominee. Beneficial interests in the global notes will be shown on, and transfers will be effected only through, records maintained by DTC and its participants. The notes are eligible for trading in the PORTAL market.

During fiscal 2004, the Company, in privately negotiated transactions, exchanged and repurchased \$24.8 million in aggregate principal amount of its convertible notes due 2008 for 9,926,339 shares of the Company's common stock and cash in the amount of \$1.9 million. In connection with the exchanges and repurchases, the Company recorded additional non-cash interest expense of approximately \$10.8 million representing the fair value of the incremental shares issued to induce the exchange and non-cash interest expense of approximately \$5.8 million representing the remaining unamortized discount for the beneficial conversion feature related to the convertible notes exchanged and repurchased. In fiscal 2004, \$684,000 of unamortized debt issue costs related to the convertible notes exchanged and repurchased was charged to additional paid-in capital, and \$54,000 was charged to expense. There were no exchanges and repurchases related to these convertible notes during fiscal 2005, fiscal 2006 or the six months ended October 29, 2006.

Unamortized debt issuance costs associated with these notes were \$1.1 million and \$1.3 million at October 29, 2006 and April 30, 2006, respectively. Amortization of prepaid loan costs are classified as other income (expense), net on the consolidated statements of operations. Amortization of prepaid loan costs for the three and six months ended October 29, 2006 were \$136,000 and \$271,000, respectively. Amortization of prepaid loan costs for the three and six months ended October 30, 2005 were \$136,000 and \$271,000, respectively.

***Convertible Subordinated Notes due 2010***

On October 15, 2003, the Company sold \$150 million aggregate principal amount of 2 1 / 2 % convertible subordinated notes due October 15, 2010. Interest on the notes is 2 1 / 2 % per annum, payable semiannually on April 15 and October 15. The notes are convertible, at the option of the holder, at any time on or prior to maturity into shares of the Company's common stock at a conversion price of \$3.705 per share, which is equal to a conversion rate of approximately 269.9055 shares per \$1,000 principal amount of notes. The conversion price is subject to adjustment.

At issuance of the notes the Company purchased and pledged to a collateral agent, as security for the exclusive benefit of the holders of the notes, approximately \$14.4 million of U.S. government securities, which will be sufficient upon receipt of scheduled